

EMPLOYEES VS INDEPENDENT CONTRACTORS

In 2006 the Office of Management and Budget received information from the American Payroll Association regarding 1099 and wage reporting. The Internal Revenue Service will begin auditing federal and state governments more closely on the practice of hiring employees as independent contractors for work outside of regular duties. IRS intends to audit cases where a W-2 and a 1099-MISC have been reported on the same taxpayer identification numbers (i.e., social security numbers) and from the same employer ID (State of North Dakota).

Workers designated as both an independent contractor and an employee of the State of North Dakota create a dual worker status, which could result in the Internal Revenue Service questioning the State's tax reporting compliance. Should the IRS determine that the worker qualifies as an employee and not an independent contractor, the agency could be liable for back payroll taxes, penalties, and/or interest. The worker may also be at risk for additional taxes, depending upon the outcome.

The Office of Management and Budget does not determine the independent contractor status of a state employee. This website is established to help agencies make this determination themselves by sharing information that OMB and the Vendor Registry has found on this subject.

REFERENCE LINKS

ND Department of Labor: <http://www.nd.gov/labor/services/ic-verification/>

ND Administrative Code: See section 27-02-14-01

ND Century Code: See N.D.C.C. § 34-05-01.4

IRS Links: <http://www.irs.gov/pub/irs-pdf/p1779.pdf>
<http://www.irs.gov/pub/irs-pdf/p963.pdf>
<http://www.irs.gov/govt/fslg/article/0,,id=110344,00.html>
<http://www.irs.gov/businesses/small/article/0,,id=99921,00.html>

Federal, State, and Local Government Newsletter:

http://www.irs.gov/pub/irs-tege/win03_fslg.pdf

Employer's Supplemental Tax Guide: <http://www.irs.gov/pub/irs-pdf/p15a.pdf>

Form SS-8: <http://www.irs.gov/pub/irs-pdf/fss8.pdf>

ND Workforce Safety and Insurance:

<http://www.workforcesafety.com/library/Documents/forms/phs/sfn53068.pdf>

<http://www.workforcesafety.com/employers/independentcontractor.asp>

OMB Fiscal Policies: <http://www.nd.gov/fiscal/docs/policies.pdf>.

See Policy 101 – Employer-Employee Relationship
and Policy 208 - Honoraria

FREQUENTLY ASKED QUESTIONS ABOUT INDEPENDENT CONTRACTOR VS EMPLOYEE

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[Who is considered a “state employee” for the purpose of payment in PeopleSoft?](#)

- a. Anyone on PeopleSoft Central Payroll. All of the state agencies on PeopleSoft Central Payroll are posted on the SPO web site at <http://www.nd.gov/spo/connectnd/manual/payroll-agencies.pdf>. This list includes legislators.

[Who is considered a “non-state employee”?](#)

- a. Anyone not on PeopleSoft Central Payroll, which would include Bank of North Dakota, Mill and Elevator, and ND Higher Education. For a complete listing, see <http://www.nd.gov/spo/connectnd/1099-information/non-state-employees.pdf>.
- b. Only individuals fitting the definition of a non-state employee as described above should receive travel reimbursements on account #521060, Non State Employee Travel.

How should agencies make payments to state employees outside of their normal scope of employment?

- a. Awards and all types of bonuses to employees must be paid through payroll.
- b. Refunds or reimbursements for travel, tuition, supplies should all be paid by AP voucher on the employee's vendor number (the EMPL ID).
- c. Payments to state employees for any type of program such as land rent, disaster payments, DHS caregiver, etc. should be paid by voucher on the employee vendor number also. Special locations can be set up by the Vendor Registry to accommodate these program payments, with specific withholding information added. The default location will remain as "HOME", without any withholding, for normal employee reimbursements.
- d. Honoraria paid to state employees outside your agency should be paid on the employee vendor as reportable income on a 1099 location. Vendor Registry can set up such a location upon request. Please be sure to notify them that the payment is 1099 reportable and supply a TIN number.
- e. The use of PeopleSoft account numbers for Honoraria (611015) and Stipends (611025) to your agency's own employees suggests an independent contractor status. Be sure that your payment fits the guidelines for an independent contractor as set forth by the IRS, ND Department of Labor, and North Dakota Century Code before issuing payment to your employees using these accounts. Stipends to employees are very rare and are usually reported on a W-2.

NOTE: The Vendor Registry has established a policy that a new vendor number will not be issued for a current state employee unless that individual is performing services under a business name and/or separate TIN.

What if a state agency needs to pay a Higher Ed employee?

- a. Higher Ed employees are to be set up as regular vendors in the vendor database when paid by a state agency – do not pay on the employee ID.
- b. If a college or university needs to pay an individual employed by a state agency, it is recommended that the employee vendor be used. If the payment is reportable income, a separate 1099 location can be added.

How can a user determine whether an individual is a State or Higher Ed employee?

- a. Contact the Vendor Registry office either by phone or email (spovendor@nd.gov) and we will look it up.
- b. Contact Central Payroll at OMB, and they can look up the individual.

Our agency hired a consultant who works for another state agency. Doesn't that make him/her an independent contractor?

- a. Keep in mind that all employees paid under the same employer identification number are considered a State of North Dakota employee, whether or not the worker is employed by your agency or another one. The status of independent contractor does not automatically apply – the twenty-point "Common Law Test" by the North Dakota Department of Labor can be used to make this determination. See <http://www.nd.gov/labor/services/ic-verification/>.
- b. Be advised that misclassification of workers without reasonable basis can have costly consequences for government agencies. If the IRS finds that a worker with dual status is really an employee in all situations, it may result in back payment of FICA, penalties, and/or interest.

[We've determined that a state employee is also an independent contractor. How should he or she be paid?](#)

- a. Once the status of "independent contractor" is determined by the agency, all paperwork such as written contracts, bid awards, etc. need to be kept on file in case of an IRS audit.
- b. Email Vendor Registry at spovendor@nd.gov to see whether a new location should be added to the employee vendor or if a totally new vendor needs to be set up. See [Note](#) above.

[Are travel reimbursements for speakers and consultants 1099-reportable?](#)

State agencies can use the following items for consideration in making this determination:

General IRS Rules for Independent Contractors

http://www.irs.gov/pub/irs-tege/fringe_benefit_fslg.pdf

Reimbursements for Travel, Transportation and Other Out of Pocket Expenses

- ✚ IF SUBSTANTIATED, do not report on Form 1099 MISC and is not taxable to the payee. *Reg. §1.274-5T(h)*
- ✚ IF NOT SUBSTANTIATED, report on Form 1099-MISC with other compensation. Taxable to payee but no withholding is required. *Reg. §1.274-5T(h); Reg. §1.274-5T(h)(2); IRC §132 (d)*.
- ✚ *Publication 463* provides information regarding accounting for independent contractors (vendors) regarding records, substantiation and reporting requirements.
- ✚ In general, all compensation for services for an independent contractor are to be reported on Form 1099-MISC when the amount is \$600 or more in a calendar year. The amounts are not subject to income or employment tax withholding [on a W-2].
- ✚ If the individual is considered an independent contractor and does not properly account to you for reimbursed expenses, then any advances or reimbursements are to be included on a Form 1099-MISC along with the compensation for their services. *Reg. §1.274-5T(h)(2)*

Some government guidelines state that travel reimbursements suggest an employer-employee relationship and not an independent contractor status. See point #20 on the ND Department of Labor's web page at: <http://www.nd.gov/labor/services/ic-verification/>.

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